In the Supreme Court of the United States

OCTOBER TERM, 1944.

No. . . . . .

CAROLA HUNTER,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ROBERT HUNTER,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

OPINIONS OF THE COURTS BELOW.

The memorandum opinion of the Tax Court (R. 75, R. 78) was not published. The Circuit Court of Appeals rendered no opinion, but entered an order only which is in the record. (R. 104.)

JURISDICTION.

This has already been stated in the preceding petition at page 2, which is hereby adopted and made a part of this brief.

STATEMENT OF THE CASE.

This has already been stated in the preceding petition at page 2, which is hereby adopted and made a part of this brief.

SPECIFICATIONS OF ERRORS.

The Circuit Court of Appeals erred:

1. In affirming the judgment of the Tax Court.

2. In holding that taxpayers' expenditures, as set forth in the petition, were not deductible as ordinary and business expenditures under the provisions of § 23(a) of the Revenue Act.

3. In holding that the determination of the Tax Court that said expenditures are not deductible and are capital additions, is conclusive upon the Circuit Court under the decision in *Dobson v. Commissioner*, 320 U. S. 489.

ARGUMENT.

Summary of the Argument.

I.

The taxpayers' expenditures were ordinary and necessary expenditures paid in carrying on taxpayers' business, and were deductible under § 23(a) of the Revenue Act.

II.

The decision of the Tax Court in a case where the facts are undisputed, is a determination of a matter of law, and is not a finding of fact which is binding upon any court.

I.

The taxpayers' expenditures were ordinary and necessary expenses paid in carrying on taxpayers' business, and were deductible under § 23(a) of the Revenue Act.

All of the items heretofore enumerated in the statement of the matter involved (page 2), were expenditures for deductible repairs and were not non-deductible capital additions.*

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* On appeal in the Circuit Court, petitioners withdrew their claim as to certain expenditures: Cost of concrete floor, $518.56; material used in reconditioning main barn, $153.14; digging trenches and drain tile, $337.90; sewer tile $17.93.

The Internal Revenue Code, page 14, provides for a deduction from gross income of all ordinary and necessary expenses paid in carrying on any trade or business. The unquestioned testimony is that these expenditures were made by the taxpayers from time to time after they acquired the farm, and as the necessity for each arose.

At the time the taxpayers purchased the property it was understood that the person from whom the farm was purchased would continue to live on the farm and operate it for the taxpayers. About two months later this man left, and the person who replaced him would not live in the house until it had been renovated. (R. 64.) Hence, the necessity arose for the expenditure of money for painting and papering the interior of the farmhouse.

About six weeks after the taxpayer purchased the property there was a heavy rain storm which caused the creek on the farm to flood the barnyard. When the taxpayer observed this he decided to return the creek to its former bed, which was located farther from the barnyard so that it would not cause damage when a heavy rain took place. (R. 65, 66.)

Neither of these expenditures were contemplated by the taxpayer when he purchased the farm, and could not possibly have been part of a plan to improve and recondition the farm because of the very sequence of uncontrolled events. These items were disallowed by the Tax Court as were all the other items on the ground that the expenditures were "for the purpose of improving and reconditioning the farm, not as an incident of current operation—an ordinary and necessary expense of carrying on business—but of putting it in shape for permanent or indefinite operation." (R. 77.)

This decision is contrary to *Illinois Merchants Trust Company v. Maniere*, 4 B. T. A. 103.

Furthermore, this land had been operated as a farm for many years, and had been so operated with the stumps,

rocks and creek in the condition they were when petitioners purchased it. The expenditures made in those respects in no way increased the value of the land. Hence the statement of the Tax Court (R. 77) that the cost of these items could be recovered through sale is wrong, as a matter of law. Likewise, as to the Tax Court's statement that they could be depreciated throughout the life of the investment. It is unnecessary to cite authorities for the proposition that land cannot be depreciated.

The Tax Court relied upon the case of *I. M. Cowell*, 18 B. T. A. 997, as authority for its holding. That case was decided by the same Judge who decided the instant case in the Tax Court. It is worthy of note that there were three dissents in the *Cowell* case, on the ground that repairs which neither materially add to the value of the property or appreciably prolong its life, but only keep it in an ordinarily efficient operating condition, may be deducted as an expense. Certainly the removal of the rocks and stumps and the change of the creek bed did not prolong the life of this property. The creek will always be there, and its bed will have to be re-excavated as frequently as it overflows and forms a new bed. This will be a recurring expense.

In using the dynamite to blast out the rocks and stumps, an overcharge of dynamite was used, and windows in petitioners' buildings and also windows in neighboring houses owned by others, including a church, were broken by the explosion. Petitioners paid for these damages, and the Tax Court disallowed it. How that could come under the theory of the Tax Court's opinion, it is impossible to understand. Certainly the damage item did not add to the value of petitioners' property, and it could not be recovered either through sale or depreciation. This is contrary to *Parkersburg Iron & Steel Company v. Burnet*, 48 F. (2d) 163 (C. C. A. 4). It is also contrary to *Marble & Shattuck Chair Company v. Commissioner*, 39 F.

(2d) 393 (C. C. A. 6), where beams and floor boards were subject to dry rot due to inadequate ventilation. The taxpayer installed a ventilator, and in doing so damaged the roof. The replacement and repair of the roof were held deductible.

Replacing broken boards in the various outbuildings is a deductible expense under the decision in *Rose, Collector of Internal Revenue v. Haverty Furniture Co.*, 15 F. (2d) 345 (C. C. A. 5), where many items identical with those here in question were allowed as deductible expenses. See also the following cases:

Treat Hardware Corporation v. Commissioner of Internal Revenue, 6 B. T. A. 768;

Grand Rapids Railroad Company v. Doyle, 245 F. 792;

Squier v. Commissioner, 13 B. T. A. 1223;

E. J. McMillan, B. T. A. Memo. Opinion, Docket 97724;

E. L. Potter, 20 B. T. A., 252;

Louise Kingsley, 11 B. T. A. 296.

Electric wiring had to be replaced because the existing wiring did not pass inspection. This was properly allowable under *John A. Schmid*, 10 B. T. A. 1152.

The items for painting the exterior of the various buildings are properly deductible under the following cases:

E. L. Potter, 20 B. T. A. 252;

Max Kurtz, 8 B. T. A. 679;

Treat Hardware Corporation, 6 B. T. A. 768.

Numerous cases sustaining all the above deductions are found in 4 *Mertens, Law of Federal Income Taxation*, § 25.32.

It is unreasonable to hold that an ordinary outside paint job which has to be repeated every few years, is a

capital investment. The same is true as to the items for replacing the gutters, downspouts and broken slate in the roofs. It is inconsistent for the Board of Tax Appeals to allow $4.29 to replace broken windows in petitioners' property, and not allow deduction for like damage caused to neighboring property because of the explosion.

The Board of Tax Appeals allowed $4.12 for whitewashing, but refused to allow anything for exterior or interior painting. Interior whitewashing will last as long as exterior painting.

There is no consistency in the holdings of the Tax Court, and they are completely out of line with all authorities cited above. The affirmance by the Circuit Court of Appeals is contrary to its own holdings in like cases, and the holdings of other circuits as shown by the cases cited.

This is not an instance where the property was being reconditioned to adapt it to another use which is the distinguishing element in some cases. Neither was it a complete reconditioning for taxpayers' own use. There is not any evidence, nor can the inference be made, that there was a plan of reconditioning in taxpayer's mind when he purchased this property. The only evidence is to the contrary as the taxpayer testified the expenditures were made from time to time as the situation arose, and this is fully corroborated by the fact that the interior of the building was not papered and painted until a new farmer was to take charge, and the creek bed was not changed until taxpayer had seen the effect of a severe storm.

Neither is it decisive that an expense may have to be incurred but once (although we claim that all the expense here would have to be incurred periodically), many expenses which occur but once are allowable deductions, such as the replacement of broken parts.

The argument was made that because the taxpayer was in the construction business that he had a general plan of improvement in mind when he bought the property. That

is not even a reasonable inference from the record as the taxpayer's construction business was not concerned with the kind of expenses that were here incurred. The taxpayer did none of the work himself, or through his construction company, and the record shows that every item of expense was incurred through contracts with other persons.

II.

The decision of the Tax Court in a case where the facts are undisputed, is a determination of a matter of law, and is not a finding of fact which is binding upon any court.

Upon argument of this case in the Circuit Court, the judges questioned each item discussed by the writer, and stated that each was a fact determined by the Tax Court under the rule in the *Dobson* case. Counsel for respondent took his cue from the statements of the court, and that was his sole argument. Unfortunately, the Circuit Court rendered no opinion, but in its judgment entry stated that there was substantial evidence to support the findings of facts and decisions of the Tax Court. (R. 104.) The judgment, therefore, is the result of the Circuit Court applying the rule in the *Dobson* case.

This Court, speaking of the Tax Court in the *Dobson* case, said:

> "Its decision, of course, must have 'warrant in the record' and a reasonable basis in the law."

Its decision here has neither. There is no disputed question of fact in the case, hence the decision of the Tax Court is purely a determination of a question at law. That is the rule that has been universally applied. It has been applied so fully as to require the discharge of a jury, when there are no controverted facts as there is no function for a jury to perform when there is no dispute concerning the facts. The court applies the law to the ad-

mitted facts. Under the rule in the *Dobson* case the decision of the Tax Court must have a reasonable basis in the law. Here the decision of the Tax Court had no warrant in the record and no reasonable basis in the law, and the Circuit Court affirmed the Tax Court.

The expenditures have admittedly been made, hence the only question is the legal effect of those expenditures—the application of the law to the facts. This is purely a question of law.

Even since the *Dobson* decision this Circuit Court has not felt itself foreclosed from examining the record, as it has said in syllabus one, to *Thal v. Commissioner*, 142 F. (2d) 874:

> "Circuit Court of Appeals in reviewing Tax Court's decision will not weigh the evidence or reasonable inferences to be drawn therefrom but may search the record to determine whether there is any substantial evidence to support Tax Court's findings of fact."

However, the Circuit Court failed to do either here, apparently feeling itself bound by the *Dobson* case, and that the determination of the Tax Court that an expenditure is a capital investment instead of a deductible expense, is a determination of a question of fact. We emphatically assert that such a determination is a question of law solely, when, as here, the facts are undisputed.

The determination of this case by the Circuit Court on the ground that there was substantial evidence to support the findings of fact, is a clear determination on the principles enunciated in the *Dobson* case. There were no facts to be found. They were admitted by the taxpayer, the only witness in the case. The denomination of the application of law to the facts as a finding of fact as decided the *Dobson* case, is without precedent except in the *Dobson* case. It is said in 57 *Harvard Law Review*, 754:

> "Closer analysis, however, discloses that the opinion moves far beyond traditional principles of review in

> treating as fact what is *commonly regarded as law*, and in suggesting that administrative finality attaches, to some unknown extent, to conclusions of law as well as findings of facts." (Italics ours.)

The above quotation is from a thoughtful and critical consideration of the *Dobson* case by Randolph E. Paul. The criticism of the *Dobson* case is so constructive, and the implications arising therefrom so clearly enunciated, that we respectfully suggest that this Court should carefully re-examine the principle of the *Dobson* decision in order that there may be no future confusion in the application of the rule by the Circuit Courts, and that Appellate Courts should not be required to construe a determination of a pure question of law as a determination of a question of fact which now seems to be required under the *Dobson* decision.

It is therefore respectfully submitted that a writ of certiorari should be granted and full review be had by this Court and the decisions below be reversed.

C. J. Hoyt,

Attorney for Petitioners.

G. F. Hammond,

Of Counsel.

APPENDIX.

Internal Revenue Code:

SEC. 23 [as amended by the Revenue Act of 1942, c. 619, 56 Stat. 798, Sec. 121 (a)]. DEDUCTIONS FROM GROSS INCOME.

(a) *Expenses.*—(1) *Trade or business expenses.*—

(a) *In general.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business,

* * * * *

(26 U. S. C. 1940 ed., Sec. 23.)

SEC. 24. ITEMS NOT DEDUCTIBLE.

(a) *General rule.*—In computing net income no deduction shall in any case be allowed in respect of—

* * * * *

(2) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate;

(3) Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made;

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(26 U. S. C. 1940 ed., Sec. 24.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.23 (a)—1. *Business expenses.*—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, * * *. Among the items included in business expenses are management expenses, * * *, labor, supplies, incidental repairs, operating expenses of automobiles used in the trade or business, traveling expenses while away from home solely in the pursuit of a trade or business (see section 19.23 (a)-2), advertising and other selling expenses, together with insurance premiums against fire, storm, theft, accident, or other

similar losses in the case of a business, and rental for the use of business property. * * *

SEC. 19.23 (a)-4. Repairs.—The cost of incidental repairs which neither materially add to the value of the property nor appreciably prolong its life, but keep it in an ordinarily efficient operating condition, may be deducted as expense, provided the plant or property account is not increased by the amount of such expenditures. Repairs in the nature of replacements, to the extent that they arrest deterioration and appreciably prolong the life of the property, should be charged against the depreciation reserve if such account is kept. * * *